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Bathurst Regional Council advocates for the Rate Peg system to be abolished. It is an outdated methodology that gives no consideration to individual circumstances faced by each council in New South Wales.

The NSW Productivity Commission, reinforced by IPART who has reached similar conclusions, has confirmed the long-held view of local government and the findings of numerous inquiries over many years that the rate peg is not working. Both the Productivity Commission and IPART have concluded that rate pegging does not provide councils with adequate revenue to fund the infrastructure and services needed to support communities. This is resulting in declining per capita revenue and a growing revenue gap. NSW per capita rates are lower than any other state and the Productivity Commission estimates that NSW councils have foregone $15 billion in rate revenue over the past 20 years compared to Victorian councils, as the result of rate pegging.

The Integrated Planning and Reporting (IP&R) framework was introduced by the NSW Government in 2009. According to the Office of Local Government (OLG), *'the IP&R Framework begins with the community's, not councils, aspirations for a period of at least 10 years. It includes a suite of integrated plans that set out a vision and goals and strategic actions to achieve them. It involves a reporting structure to communicate progress to council and the community as well as a structured timeline for review to ensure the goals and actions are still relevant.*' Despite these comprehensive planning and reporting requirements and the extensive community consultation that has been introduced along with them, there has been no significant changes to rate pegging. The IP&R framework should be the basis for individual councils to determine their own increases within a new framework overseen by IPART in the same way that other entities under IPART's scrutiny do or, at the very least, have a large influence on the government's rate pegging policy. This is supported by the process engaged in last year with the Additional Special Variations applied for by many councils, where the future plans of each Council were considered in a timely manner by IPART to approve or reject applications.

The current Local Government Cost Index (LGCI) generally achieves what it is designed to do during periods of stable inflation but fails in periods of volatility. The 26 cost components are not reflective of all council's costs or all types of council costs and the 2-year lag needs to be addressed to align more closely with the current financial climate. The LGCI, as its name suggests, looks at costs only and not situations councils face with lost or diminishing revenue streams.

The local government state award provides councils with a clear future pathway for wages growth. This in connection with each council's 10 year Long Term Financial Plan (LTFP) and 4 year Delivery Program (DP) as part of the IP&R framework significant and objective data is available to align the peg with a future facing LGCI. Up to date data that closes the gap in the lag and aligns more closely with the financial situation at the time should be part of future determinations.

Council does not believe that the LGCI is allowing councils to keep pace with their costs which is demonstrated by the number of Special Rate Variation (SRV) applications applied for from year to year. Past expenditure patterns are not considered an appropriate indicator of future expenditure. Every year there's another need, another function to perform without any additional funds unless Council applies for a SRV, which is an intense, costly and protracted process.

Council believes that IPART needs to also consider recurrent costs of capital projects that are often funded (fully or partially) by other levels of government. These capital works projects are often of a standard or size that offer regional benefits but once built have to be maintained by the Council with no future funding source. Not only can this be a sizeable burden, but it is not identified in the current methodology.

If not altogether removed, the rate peg needs to;

- be future facing as much as possible,
- acknowledge IP&R and allow flexibility,
- avoid assumptions that past expenditure will be the future expenditure,
- address volatility;
    - if using retrospective data points through rolling averages
    - if future facing estimates with a true-up,
- account for diminishing income streams (eg Financial Assistance Grant)
- account for compliance costs
- incorporate anticipated costs to meet targets set by other levels of government
- include a component for councils to address resilience and climate change
- enable a simpler mechanism for councils to automatically have known additional factors incorporated in their peg without the need for a Special Rate Variation.

In this submission Council has responded to each of the twenty items on which IPART are seeking feedback. The responses are provided below.

Response to questions presented in the IPART Issues Paper:

1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?

The LGCI generally achieves what it is designed to do in periods of stable inflation, that is, reflect the *average* costs across all NSW councils based on 26 cost components. However, it fails to reflect the differences between councils.

The two-year lag between cost changes being reflected in the peg has recently been highlighted as a significant issue when considerable changes occur. Current inflation is running at high levels but has been consistently running at low levels (around 2% per year), and accordingly the LGCI calculation has remained at the stable levels instead of being adjusted to expected levels. In times of volatility and somewhat unpredictable inflation, the effect can be (and has been) very dramatic and does not align with community needs or expectations.

The current methodology uses CPI for 11 of the 26 cost components selected at a single point in time, this practice does not account for any anomalies between metropolitan and rural areas. One of those indicators is transport costs in recent months have risen steeply and whilst this may affect metropolitan councils somewhat, it is a major cost for regional and rural councils where both the cost of fuel is higher than in the metropolitan area and also results in freight costs for the same materials being much larger.

To avoid volatility in the rate peg the use of a rolling 3-year average of the historical LGCI weighted at 50% with a forward-looking forecast projecting inflation weighted at 50%. The estimation uncertainty of the forward forecast will then correct itself by being factored into the next year rolling 3-year average.

2. What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?

There is significant data collected which is publicly available, the number of cost components could be increased to better measure overarching costs but as each council is significantly different in the way it services its community it is not considered possible to capture everything.

The 2 year lag needs to be significantly reduced or removed, but preferably, a reliable forward looking measurement of actual cost changes should be used, as noted above.

IPART should incorporate the anticipated costs for councils to meet targets set by other levels of government. There are many currently in place that Council would encourage IPART to accommodate. Council also suggests having a mechanism that can monitor and account for new targets as they arise.

Council suggests the peg include a component for councils to address resilience and climate change. This is a known need across every council, however the type of work to be costed may differ between councils. A resilience factor should incorporate pro-active work and maintenance, as well as immediate costs to deal with catastrophic events such as bushfires and floods. Our community expects their local government to be undertaking this work, but Council is not adequately resourced or financed to achieve what is required of it.

In addition, Council asks for a simple mechanism to be introduced to annually notify IPART of known and evidenced additional factors that need to be incorporated into their rate peg.

3. What alternate data sources could be used to measure the changes in council costs?

Council's preference is for the rate peg to be forward facing as much as possible.

The Local Government (State) Award provides known increases for a period of three years, this index could be used to forecast future labour costs. Council data may also assist IPART with wages growth and any additional costs associated with attracting quality staff. Council, like all other employers in the current financial climate, is having trouble attracting quality staff at the wages and conditions allowed by the Award that it operates under.

The Reserve Bank of Australia (RBA) and the Federal Government, in its budget process, produce forecast CPI.

As mentioned above, state and federal documents imposing targets and requirements on councils should also be used as sources to identify future costs to councils, along with councils' own gap analysis.

4. Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?

Again, the issue with tangible indices is the lag between the growth period and the year it will be added to the LGCI to determine the rate peg limit. For the financial year 2022-23 the Estimated Residential Population (ERP) used was the growth measure between 2019 and 2020. The range of population growth factors was between 0 and 4.3%.

As part of the calculation is a factor regarding natural growth due to supplementary valuations. This growth was a factor allowing councils to grow with the communities they serve. Growth from supplementary valuation changes is deducted from the population factor, but cannot be a negative value.

The attempt by IPART to prevent councils from 'double-dipping' by subtracting supplementary rates growth from the population increase is flawed because it doesn't account for negative supplementary growth. This means that councils with negative supplementary growth are not afforded their full population increase.

Further improvements to consider are:

- Closing the gap between the growth factor and the relevant LGCI year
- Possibilities to relate to changes in demographics
- Identifying any alignment or timing issues between when subdivisions (supplementary values) occur and population increases
- Allowing negative supplementary valuation changes to be regained through the population factor (i.e. Allowing the 'supplementary valuations percentage' to be a negative number so that when it is deducted from the 'change in population' it is added back). Council believes that this should be revisited for the reasons outlined.

5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?

Each council has different service levels and community needs and expectations, improvements in productivity are part of our IP&R process. Any productivity gains should be encouraged and allowed as they will surely encourage future productivity gains that will benefit their communities. Penalising councils for efficiency gains is a disincentive for innovation and should be removed.

Productivity improvements should be removed from the rate peg methodology. Productivity cannot be accurately measured across the local government sector as councils are too diverse.

6. What other external factors should the rate peg methodology make adjustments for? How should this be done?

The main external factor to drive the rate peg should be the services identified by the community during the IP&R process, that can be efficiently delivered and resourced by Council in its LTFP considerations.

If a new cost is identified by the IPART or the OLG and it is expected to have a uniform impact on the sector (as with above) then a factor should be applied in the relevant LGCI. The factor may only affect one year and therefore it is reasonable to expect a similar reducing factor in the following year. If the impact is permanent, i.e. the costs are going to have an effect ad infinitum the factor should not be removed in the following LGCI.

Council also holds the view that the methodology should be modified to allow adjustments for external factors that affect groups of councils, affect councils unevenly or affect individual councils. For example, the Emergency Services Levy (ESL) that has been included in the peg, does not fall evenly across councils, with the heaviest burden proportionally falling on rural and regional councils with a high RFS presence.

7. Has the rate peg protected ratepayers from unnecessary rate increases?

This is a nonsense statement and flies in the face of Integrated Planning and Reporting. Further it is an exemplar of the pervasive and unhelpful thinking that somehow the State needs to manage 'bad' Local Government through a sectoral response.

Council does not believe in the philosophy of unnecessary rate increases. Political pressure to keep land rates low achieves only one result, poor outcomes for the community. Local councils strive to provide the best possible works, services, facilities and infrastructure to their communities and political decisions at both the local and state level to keep land rates low and running with a vernacular of protection is fictitious at best.

Moreover, decisions to keep rates low can lead to opposite outcomes. Councils may delay increases in rates as a pseudo protection only to eventually have no choice but to apply for high percentage increases that have significant impact on the community, in particular, the vulnerable.

Importantly, NSW councils adhere to strict IP&R frameworks that require extensive community consultation that allows for intervention by the community and mandates numerous consultation steps. It is important to note that the IP&R framework was not in place when rate pegging/capping was introduced in 1977 yet the NSW Government has made no concessions to allow the ratepayers of NSW more choices in how the community can be better funded.

Instead, we see the same rhetoric around protecting ratepayers from excessive raises.

Accordingly, a process should be investigated that enables councils to align their rates with the outcomes from the Community Strategic Plan, (CSP) for the relevant period. For example, if the community identifies a need (in the CSP) for funding that results in increase variations each year that exceeds the IPART peg limit. The IP&R process starts with the CSP, resourcing of the plan is determined in the Delivery Plan (DP) which is funded annually by the OP. This model aligns with question 13 and 14 in the Issues Paper.

A mechanism of recommending a factor for councils that have a financial need to remain sustainable should be included.

8. Has the rate peg provided councils with sufficient income to deliver services to their communities?

No. This is why councils seek a SRV from time to time, many on the grounds of Financial

Sustainability. IPART accepts this and grants a SRV, at the same time disadvantaging other councils with an out of touch rate peg. Obviously IPART recognises that councils require extra rate income to keep operating business as usual through granting SRV applications, therefore why are others constrained?

Further, it forces Councils to push their liabilities into the future making our children pay for today's broken system. This is outside the principles of intergenerational equity enshrined in the Local Government Act.

9. How has the rate peg impacted the financial performance and sustainability of councils?

This is a subjective question as not all councils are the same. Historically it is dependent on the decisions made by each council and the rate base the council had when rate pegging was introduced. Moderate and affordable increases over many years must be a preference over sharp increases by way of an SRV every 5-10 years. Such moderate/affordable increases would play a significant role in also addressing sustainable intergenerational equity.

Following on from the NSW Governments 'Fit for the Future' investigation a number of councils found it necessary to apply for significant rate increases to remain financially sustainable. Essentially, this situation leads to injustices in intergenerational equity as the current and future ratepayers are paying for mistakes by preceding councils that had not raised the appropriate fair and equitable land rates.

Instances of deferring liabilities to future generations to deal with should be considered and made easier to prevent.

In the last 10 years:

- 178 councils applied for a SV
- 165 applications were approved in full or in part
- 142 applications rationalised based on one or all of the following to address:
    - financial sustainability,
    - existing infrastructure backlogs,
    - future infrastructure expenditure obligations.

In addition to this, the last 3 years:

- 79 councils reported an infrastructure renewal backlog of greater than 2%
- 56 councils consistently reported an infrastructure backlog of greater than 2%
- 99 Councils reported an infrastructure renewal ratio of less than 100%
- 33 Councils consistently (over 3 years) reported an infrastructure renewal ratio of less than 100%
- 74 Councils reported an infrastructure renewal ratio of less than 100% over a 3-year average

The above statistics clearly show that a large majority of NSW councils are balancing their operational budgets by underfunding its capital obligations.

Based on the number and size of SRV applications in the last 10 years and the deterioration of councils' asset sustainability indicators over the least 3 years, it can be said that the rate peg has prevented necessary rate increases.

The rate cap has forced Councils to

- Find efficiencies with the perverse outcome of incentivising cutting corners
- Reduce services, lessen maintenance on infrastructure
- Delay maintenance
- Undermine service provision
- Enter financial stress
- Fail to deliver on their Community Strategic Plans

10. In what ways could the rate peg methodology better reflect how councils differ from each other?

Historical modelling may identify material differences and if this occurs there may be an argument that supports multiple pegs on this basis.

11. What are the benefits of introducing different cost indexes for different council types?

The LGCI may be more in tune with each council's actual costs of providing services to their communities.

It should also be noted that there is a material difference between metropolitan council costs and regional council costs (or other cohorts) there may be an argument that supports different cost indexes.

12. Is volatility in the rate peg a problem? How could it be stabilised?

Yes. The IPART will be fully aware of the challenges councils recently presented with the 2022-23 LGCI being released at 0.7%.

To stabilise the LGCI the data used needs to align more closely with the current financial environment and possibly using a period of rolling averages. It would preferably be based on the future landscape rather than historical. Presently council applications for a SRV are assessed on where that council is heading and a proven lineage to the future needs being demonstrated in the council DP as part of the IP&R requirements.

Accordingly, when it comes to the bespoke application to go beyond the standard rate peg the IPART looks toward that councils' future costs and future financial position not what the historical costs were. If this principle could be incorporated into the LGCI it would be more easily understood by the community and more closely align the LGCI with the SRV process.

13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

Predicting future CPI inflation for the long term is difficult and of concern. A better alignment to actual costs is recommended and the use, where possible, of known future costs indexes (e.g. NSW Local Government (State) Award for labour costs) and the RBA forecast CPI.

14. Are there benefits in setting a longer term rate peg, say over multiple years?

This is a possible solution, however ratepayers should have a greater say in how their council is operating and to determine the level of services and quality of life that aligns best with their ability to pay for those services. Inflation volatility, pandemics and natural disasters can contribute to the community's ability to pay and also add to the operating costs of individual councils differently.

To avoid volatility in the rate peg the use of a rolling 3-year average of the historical LGCI weighted at 50% with a forward-looking (RBA CPI) forecast projecting inflation weighted at 50%. The estimation uncertainty of the forward forecast will then correct itself by being factored into the next year rolling 3-year average.

This approach can provide stability in smoothing of the long-term revenue to match the growth in long term expenditure and any resulting efficiency gains through economies of scale.

15. Should the rate peg be released later in the year if this reduced the lag?

No. Councils need to prepare their Operating Plan (budget) early in the financial year to meet exhibition timelines, the current release dates support this outcome.

The release of an indicative peg within the existing timeline to assist with planning and locking in a final peg as late as practical may be a solution.

16. How should we account for the change in efficient labour costs?

Council believes accounting for actual labour costs should be aligned with changes in the NSW Local Government (State) Award to be more reflective of Council's costs. The cost of attracting quality staff should also be factored in, these costs may be identified through sector based advertising agencies.

Council does not believe that productivity factors can be accurately measured in a sector as diverse as local government.

Any efficiencies gained should be applied to the deficit of the provision of services and infrastructure and do not translate into surpluses.

17. Should external costs be reflected in the rate peg methodology and if so, how?

Yes. Have an LGCI and then add an additional factor based on the applicability.
Flag specific costs for specific councils or cohorts of Councils.
The geographic size and population density of the LGA should be a consideration.

18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?

Council specific adjustments for external costs are needed, examples of external costs include but are not limited to;

- Tracking Federal and State imposed targets, and the cost to achieve them,
- Utilising the IP&R documents to understand any future needs of each council,
- Creating a simple 'council submission' process that enables the exchange of information to enable IPART visibility and approval,
- Audit and Risk Management Committee (ARMC),
- Compliance (pool inspections, food shop) and others,
- Stormwater Management Charge – charges set by regulations and unchanged since 2006-07,
- Cost-shifting has an impact on how income from land rates is diverted, Council opposes all forms of cost shifting and the imposts on local communities, this data is provided for information purposes only and it should not be included as an adjustment for external costs:
    - The waste levy is the single biggest contributor to cost shifting in NSW, in 2015/16 $305 million was lost because the NSW Government did not fully reinvest the waste levy, paid by councils, back into local government environmental programs.
    - Councils paid $127 million in mandatory local government contributions to fund the state government's emergency service agencies in 2015/16.
    - The NSW Government makes the lowest per capita contribution to public libraries of any state/territory government in Australia at just $3.76 per capita in 2015/16. Councils footed the bill for a $130 million shortfall in funding required to operate the state's 450 public libraries.
    - Councils lost $61 million in 2015/16 through the NSW Government's failure to fully reimburse councils for mandatory pensioner rate rebates,

unlike all other state/territory governments in Australia.
- Councils incur significant costs for activities required to meet regulatory burdens associated with companion animals, noxious weeds, flood controls and other activities.

19. What types of costs which are outside councils' control should be included in the rate peg methodology?

Costs that apply to all councils uniformly should be included in the rate peg methodology.

Local government has been subject to significant cost shifting from other levels of government. The mandating of the NSW Audit Office as the supplier of audit services has resulted in an increase in audit fees of 88% over 9 years.

Changes to legislation that affect all councils, often result in additional costs to the local community, examples include but are not limited to the mandating of the audit office, rather than competitive tendering and superannuation payments for elected councillors.

20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

Given the application of the process as it stands is so bad, there is no way out of introducing complexity to manage a poor situation. It goes without saying that ending rate pegging would simplify matters significantly.

- Allowing councils to increase rates 2-3% above the rate peg without SRV application would reduce the use of SRVs to fund sustainability. This option has previously been raised by councils and included as an interim measure to the ending of rate pegging by LGNSW. This makes the peg more of a reference rate. It would make councils more accountable to their communities and is consistent with allowing councils bot to adopt the rate peg.
- Simplify the Special Rate Variation application process.
- Introduce quality control measures so that there will never be a 0.7% rate rise again.

Closing the gap in the data used from historical sources needs to be a priority.

Conclusion

In conclusion, in the absence of removing the rate peg in its entirety, Council welcomes any opportunity to work closely with IPART on creating a better model that will lead to financial sustainability for Councils.

Thank you for the opportunity to comment on the draft report, if you have any questions about Council's submission please do not hesitate to be in touch.